PRACTICE EXAM 24: ENROLLED AGENT PART 2 BUSINESSES SIMULATION (100 QUESTIONS)

This simulation mirrors the structure of the IRS Special Enrollment Examination, Part 2 - Businesses. It contains 100 multiple-choice questions with four answer options, weighted to the official domain proportions: 35 questions on Business Entities and Considerations, 44 on Business Tax Preparation, and 21 on Specialized Returns and Taxpayers. Allow 3 hours and 30 minutes. All questions relate to tax year 2025 and to the law as amended through December 31, 2025. The scaled passing score on the actual examination is 500 on a scale of 200 to 800. Answer every question; there is no penalty for a wrong answer.

1. A married couple filing jointly sells qualifying Section 1244 stock with a 180,000 dollar basis for 40,000 dollars. How is the 140,000 dollar loss characterized?

A. One hundred thousand ordinary and forty thousand capital
B. One hundred forty thousand dollars entirely as ordinary loss
C. Fifty thousand ordinary and ninety thousand as capital loss
D. One hundred forty thousand dollars entirely as capital loss

2. A corporation distributes property with a 120,000 dollar basis and 340,000 dollar value in complete liquidation. What does the corporation recognize?

A. Two hundred twenty thousand dollars of gain as if it had sold
B. No gain, because a liquidating distribution is not a sale
C. Three hundred forty thousand dollars, the full property value
D. One hundred twenty thousand dollars, equal to the asset basis

3. The sole shareholder in that liquidation has a 95,000 dollar stock basis. What does the shareholder recognize and what basis is taken?

A. Two hundred twenty thousand gain and a basis of one hundred twenty thousand

B. Two hundred forty-five thousand dividend income and a basis of ninety-five thousand
C. Two hundred forty-five thousand gain and a basis of three hundred forty thousand
D. No gain, with a carryover basis of one hundred twenty thousand

4. A parent corporation owning ninety percent of a subsidiary liquidates it. What is the consequence?

A. Both parent and subsidiary recognize gain on the distribution
B. The parent takes a fair market value basis in the assets received
C. The subsidiary recognizes gain but the parent recognizes none
D. Neither recognizes gain, and the parent takes a carryover basis

5. A corporation lends its shareholder 250,000 dollars at no interest when the applicable federal rate is five percent. What is the annual consequence?

A. Twelve thousand five hundred dollars imputed as a dividend to the shareholder
B. No consequence, because the loan principal is fully repayable
C. Two hundred fifty thousand dollars treated as a dividend immediately
D. Twelve thousand five hundred dollars deductible by the corporation

6. Which element completes the accrual method test for deducting a liability?

A. Approval of the expenditure by the entity's governing body
B. Receipt of an invoice from the provider before the year closes
C. Economic performance with respect to the item in question
D. Payment of the liability before the close of the taxable year

7. Which condition permits the recurring item exception to accelerate a deduction?

A. Payment of at least half the liability before the year closes
B. A written election filed with the return for the earlier year
C. Performance within eight and a half months after the year closes

D. Performance within thirty days after the close of the year

8. Which requirement applies to stock qualifying for the Section 1202 exclusion?

A. The stock must be acquired at original issue from the corporation
B. The stock must be held for at least three years before disposition
C. The issuing entity must be an S corporation at the issue date
D. The stock must be purchased from an existing shareholder

9. A corporation has 500,000 dollars of adjusted ordinary gross income of which 320,000 dollars is personal holding company income. What follows?

A. The corporation is automatically treated as a personal holding company
B. The accumulated earnings tax applies instead of any other levy
C. The income test is met, and the ownership test must also be checked
D. No consequence, because the percentage falls below the stated threshold

10. A corporation changing its year end reports 180,000 dollars over a nine-month short period. How is the tax computed?

A. By annualizing to 240,000 dollars, computing tax, then multiplying by nine twelfths
B. By applying the ordinary rate to the 180,000 dollars actually earned
C. By deferring the short period income into the following full year
D. By dividing the annual tax on 180,000 dollars across four quarters

11. Which reorganization involves an acquisition of stock solely for voting stock?

A. A transfer of assets followed by a distribution of shares
B. A Type B reorganization requiring control immediately afterward
C. A statutory merger or consolidation under state law
D. A recapitalization altering the corporation's own capital structure

12. Which consequence follows a failure of the continuity of interest requirement?

A. The transaction is treated as a fully taxable acquisition
B. The reorganization is respected but boot becomes fully taxable
C. The acquiring corporation loses the target's tax attributes only
D. The parties may elect either taxable or tax-free treatment

13. Which corporations are aggregated under the controlled group rules?

A. A parent-subsidiary group connected through eighty percent ownership
B. Any corporations sharing at least one common officer or director
C. Corporations operating in the same industry within a single state
D. Corporations filing their returns with the same service center

14. Which item may not be deducted currently on a sale between related parties?

A. Compensation for services actually rendered during the year
B. A loss realized on the sale of property to the related party
C. Interest accrued and paid within the same taxable year
D. Rent paid at market rate for genuinely used business premises

15. Which method must generally be used for a long-term construction contract?

A. The completed contract method for every contractor alike
B. The installment method, spreading gain across the payments
C. The percentage of completion method, based on costs incurred
D. The cash method, matching receipts to the period collected

16. Which inventory method values goods at the most recent purchase costs?

A. First-in, first-out, leaving the newest costs in inventory
B. Last-in, first-out, leaving the oldest costs in inventory
C. Specific identification, tracking each individual item's cost
D. The retail method, working backward from selling prices

17. Which business casualty loss is deductible without regard to a federally declared disaster?

A. A loss arising from ordinary wear and tear over several years
B. A loss from a declining market value of business inventory
C. A loss on property used in a trade or business or for investment
D. A loss on personal-use property held by the business owner

18. Which expenditure must be capitalized under the improvement standards?

A. A repair restoring the property to its ordinary operating condition
B. An expenditure adapting the property to a new or different use
C. Routine maintenance performed more than once in ten years
D. An amount paid to inspect and clean the property periodically

19. Which vehicle escapes the passenger automobile depreciation caps entirely?

A. A luxury vehicle costing more than one hundred thousand dollars
B. A van modified so it cannot reasonably be used for personal travel
C. A sedan used exclusively for business travel by employees
D. A vehicle leased rather than purchased by the business

20. How are specified research and experimental expenditures treated under current law?

A. Capitalized and amortized over a period fixed by statute

B. Deducted currently in the year the expenditures are incurred
C. Added to the basis of any resulting patent or process
D. Recovered only when the research project is finally abandoned

21. Which requirement distinguishes a business bad debt from a nonbusiness one?

A. The debt must have been outstanding for more than one year
B. The creditor must have attempted collection through the courts
C. The debt must be proximately related to the creditor's business
D. The debt must be evidenced by a formal written instrument

22. Which employment tax return does an employer of agricultural workers file?

A. The annual return specific to agricultural employees
B. The quarterly return used by most ordinary employers
C. The annual return available to the smallest employers
D. The annual federal unemployment tax return only

23. When must backup withholding be applied to a reportable payment?

A. Whenever the payee is an entity rather than an individual
B. When the payee fails to furnish a correct identification number
C. Whenever the payment exceeds the information return threshold
D. When the payee has an outstanding balance owed to the Service

24. Which transaction triggers the cash reporting requirement on Form 8300?

A. Receipt of more than ten thousand dollars in cash in one transaction
B. Any deposit into a business account exceeding ten thousand dollars
C. Payment of more than ten thousand dollars to a single vendor
D. Any wire transfer received from an overseas customer

25. Which fringe benefit is excluded as a working condition benefit?

A. A professional subscription the employee would otherwise deduct
B. A cash allowance paid monthly for general business expenses
C. Reimbursement of the employee's personal commuting costs
D. A gift certificate provided at the close of the calendar year

26. Which arrangement permits a small employer to reimburse individual health premiums?

A. A flexible spending arrangement funded by salary reduction
B. A qualified small employer health reimbursement arrangement
C. A cafeteria plan offering a choice among taxable benefits
D. A health savings account funded by the employer directly

27. Which condition applies to a loan taken from a qualified retirement plan?

A. The loan must be approved by the plan's actuary in advance
B. The loan may not exceed one quarter of the vested balance
C. The loan must generally be repaid within five years by level payments
D. The loan must be repaid before the participant changes employers

28. Which item is income in respect of a decedent for a business owner?

A. Accounts receivable of a cash-basis proprietor unpaid at death
B. Appreciation in the value of business real property held at death
C. The decedent's remaining basis in depreciable business equipment
D. A partnership interest passing to the surviving spouse

29. Which election permits administration expenses to be claimed on the income tax return?

A. A waiver of the deduction on the federal estate tax return
B. An election made within nine months of the date of death
C. An election by the beneficiaries on their own individual returns
D. An election requiring consent of the residuary legatees

30. Which characteristic defines a charitable remainder annuity trust?

A. A fixed dollar amount paid annually from the trust to the beneficiary
B. A fixed percentage of assets revalued annually to the beneficiary
C. Payment to charity first with the remainder to individuals
D. Discretionary distributions determined each year by the trustee

31. Which election gives an exempt organization an objective lobbying limit?

A. The expenditure election measuring lobbying against a sliding scale
B. An election to treat all lobbying as an unrelated business activity
C. An election to report lobbying separately from program services
D. An election to allocate lobbying costs to member dues received

32. Which substantiation must a donor obtain for a contribution of 500 dollars?

A. A bank record or written communication from the organization
B. A contemporaneous written acknowledgment from the charity
C. A completed noncash contribution form attached to the return
D. A qualified appraisal prepared by an independent appraiser

33. Which item does the aggregation election under the qualified business income rules permit?

A. Combining a specified service business with a qualifying one

B. Combining separate trades or businesses meeting common ownership tests
C. Combining the deduction with the standard deduction amount
D. Combining income across two consecutive taxable years

34. Which factor is considered in determining whether an activity is engaged in for profit?

A. The number of employees the activity supports during the year
B. The manner in which the taxpayer carries on the activity
C. The taxpayer's total gross receipts across all business activities
D. The physical location where the activity is conducted

35. Which condition permits an S corporation to make a late election with relief?

A. Reasonable cause for the failure together with prompt corrective filing
B. Unanimous written consent of every shareholder within thirty days
C. Payment of a penalty equal to one percent of corporate income
D. Approval by the state in which the corporation is organized

36. Which item does an S corporation's other adjustments account hold?

A. Earnings and profits accumulated during C corporation years
B. Amounts distributed in excess of the shareholder's stock basis
C. Tax-exempt income and the expenses related to that income
D. Income already taxed to shareholders but not yet distributed

37. Which consequence follows a distribution of appreciated property by an S corporation?

A. The shareholder alone recognizes gain on receiving the property
B. The corporation recognizes gain as if it had sold at fair value
C. No gain arises because the corporation is a pass-through entity
D. The gain is deferred until the shareholder disposes of the property

38. Which entity must file a return even where it has no taxable income?

A. A domestic partnership carrying on any business during the year
B. A single-member limited liability company treated as disregarded
C. A grantor trust reporting entirely on the grantor's own return
D. A qualified subchapter S subsidiary electing disregarded status

39. Which amount is used to measure an at-risk taxpayer's exposure after a loss?

A. The fair market value of the activity's underlying assets
B. The taxpayer's share of the activity's outstanding liabilities
C. The amount remaining after prior losses have reduced the figure
D. The original amount contributed at the outset of the activity

40. Which requirement applies to a valid Section 754 election?

A. It applies to the transferring partner only rather than the entity
B. It must be renewed with each subsequent transfer of an interest
C. It requires the unanimous written consent of all the partners
D. It applies to all future transfers and distributions until revoked

41. Which item reduces a partner's capital account but not outside basis?

A. An allocation of deductible business expenses for the year
B. The partner's share of a decrease in partnership liabilities
C. A revaluation of partnership property on admitting a new partner
D. A distribution of cash made during the taxable year

42. Which allocation must a partnership make on contributed built-in gain property?

A. An equal allocation of the gain among all of the partners
B. An allocation of the built-in gain to the contributing partner
C. An allocation according to the partners' capital account balances
D. No special allocation, because the property took a carryover basis

43. Which consequence follows a disguised sale of property to a partnership?

A. The transaction is recharacterized as a taxable sale to the entity
B. The partnership takes a fair market value basis with no gain
C. The contributing partner recognizes gain only on later distribution
D. The transaction is respected because contributions are tax free

44. Which item must a partnership furnish to a partner receiving a guaranteed payment?

A. A Form W-2 reporting the amount as wages subject to withholding
B. A Schedule K-1 separately stating the guaranteed payment amount
C. A Form 1099 reporting the payment as nonemployee compensation
D. No statement, because guaranteed payments are simple draws

45. Which condition must be met before a partnership may deduct organizational expenses?

A. The partnership must have operated for at least twelve months
B. The expenses must be approved by a majority of the partners
C. The partnership must have begun its active business operations
D. The expenses must have been paid rather than merely accrued

46. Which item is a syndication cost that is never recoverable?

A. Accounting fees for establishing the partnership's books

B. Commissions paid for selling partnership interests to investors
C. Legal fees for negotiating the partnership agreement itself
D. Filing fees paid to the state on forming the partnership

47. Which requirement applies where a partnership has foreign partners?

A. Withholding on effectively connected income allocable to those partners
B. A separate return filed for each foreign partner individually
C. Conversion of the partnership into a corporation for tax purposes
D. Election out of the centralized partnership audit procedures

48. Which item must be reported where a partnership interest changes hands?

A. Notification by the transferor to the partnership of the transfer
B. The transferee's own basis in the partnership interest acquired
C. A revaluation of every remaining partner's capital account
D. Immediate termination of the partnership's taxable year

49. Which item passes through to shareholders as a separately stated item?

A. Foreign taxes paid by the corporation during the taxable year
B. Depreciation on machinery used in the ordinary operations
C. Rent paid for the corporation's business operating premises
D. Salaries paid to non-shareholder employees during the year

50. Which consequence follows an inadvertent termination of an S election?

A. Relief may be available where the terminating event is corrected
B. The corporation must wait five years before electing again
C. The termination is permanent with no relief available at all
D. The corporation is treated as a partnership for the interim period

51. Which cost is included in the basis of self-constructed business property?

A. Advertising promoting the facility before it opens for business
B. Training of staff who will eventually operate the new facility
C. Insurance covering the completed facility after it opens
D. Interest incurred during the construction production period

52. Which item is recovered through amortization rather than depreciation?

A. A warehouse building acquired as part of the same purchase
B. Delivery vehicles transferred with the acquired business
C. A covenant not to compete acquired with a going business
D. Office furniture included in the acquisition of the business

53. Which condition allows a taxpayer to expense environmental remediation costs?

A. The expenditure must restore the property to its prior condition
B. The contamination must have been caused by an unrelated party
C. The costs must exceed a stated percentage of the property basis
D. The remediation must be ordered by a federal regulatory agency

54. Which expenditure qualifies for the research credit as a qualified research expense?

A. Wages paid to employees directly performing qualified research
B. Costs of adapting an existing product for a particular customer
C. Expenses of research conducted entirely outside the country
D. Costs of surveys, studies, and routine data collection work

55. Which limitation applies to the general business credit in a given year?

A. Each component credit carries its own separate annual limitation
B. The credit is capped by reference to net income tax and tentative minimum tax
C. The credit may not exceed twenty-five percent of gross receipts
D. The credit is limited to the taxpayer's total wage expense

56. Which entity may claim the work opportunity credit?

A. Only employers with fewer than fifty full-time equivalent workers
B. Only employers operating within a designated empowerment zone
C. Any employer providing health coverage to its new employees
D. Any employer hiring an individual from a certified targeted group

57. Which requirement applies to claiming the disabled access credit?

A. The business must have gross receipts below a stated ceiling
B. The expenditure must exceed ten thousand dollars in the year
C. The building must have been placed in service before 1990
D. The business must employ at least one disabled individual

58. Which item must an employer include on a Form W-2 for an employee?

A. Employer contributions to a qualified profit sharing plan
B. The taxable value of personal use of a company vehicle
C. The employer's share of Social Security tax on the wages
D. Reimbursements paid under a properly documented accountable plan

59. Which condition permits an employer to correct an employment tax error?

A. Filing the adjusted return by the due date of the next quarter

B. Obtaining written approval from every affected employee first
C. Filing an amended return within three years of the original filing
D. Filing the correction on the annual unemployment tax return

60. Which penalty applies where information returns are filed late?

A. A tiered penalty rising with the length of the delay
B. A flat penalty regardless of how late the filing occurs
C. A penalty equal to the tax that should have been withheld
D. No penalty where the payee reported the income correctly

61. Which item is a deductible expense of an estate on the fiduciary income tax return?

A. Fees paid to the executor for administering the estate
B. Funeral expenses paid from the estate's available assets
C. Federal estate tax paid on the decedent's taxable estate
D. Distributions of principal made to residuary beneficiaries

62. Which condition must a trust satisfy to qualify as a simple trust for a year?

A. It must hold only publicly traded securities and cash
B. It must have exactly one income beneficiary named
C. It must distribute all income currently and make no charitable gifts
D. It must have been created during the grantor's lifetime

63. Which item is allocated between a trust and its beneficiaries under the regulations?

A. Capital gains allocated to corpus under the governing instrument
B. Depreciation on trust property producing rental income
C. The trustee's fee for administering the trust during the year
D. Tax-exempt interest received on municipal obligations held

64. Which condition triggers the estate's requirement to file an income tax return?

A. Gross income of six hundred dollars or more for the taxable year
B. Any taxable income whatever during the period of administration
C. Total estate assets exceeding six hundred dollars in value
D. Any distribution made to a beneficiary during the taxable year

65. Which election permits a qualified revocable trust to be treated as part of an estate?

A. An election by the beneficiaries to consolidate their reporting
B. The election combining the trust with the estate for income tax purposes
C. An election to treat the trust as a grantor trust after death
D. An election to distribute all trust income currently each year

66. Which item is not counted toward the public support test?

A. Gross receipts from an unrelated business activity conducted
B. Contributions received from the general public in small amounts
C. Grants received from a governmental unit for exempt purposes
D. Membership fees paid by individual supporting members

67. Which consequence follows where a public charity fails the support test?

A. Imposition of the tax on unrelated business taxable income
B. Reclassification as a private foundation with its excise taxes
C. A requirement to distribute all accumulated income currently
D. Immediate revocation of the organization's exempt status

68. Which activity is a taxable expenditure by a private foundation?

A. Reasonable administrative expenses of operating the foundation
B. A grant to an individual without advance approval of the procedures
C. A grant made to another private foundation for exempt purposes
D. Investment of foundation assets in publicly traded securities

69. Which item does a section 501(c)(3) organization risk by endorsing a candidate?

A. A requirement to file an additional disclosure schedule
B. Loss of exemption, since political campaign activity is prohibited
C. An excise tax with no effect on its exempt status
D. Reclassification as a social welfare organization instead

70. Which condition applies to a defined benefit plan that a defined contribution plan does not?

A. An annual actuarial valuation and minimum funding requirement
B. A limit on the amount an employee may defer each year
C. Immediate vesting of all employee elective contributions
D. A prohibition on loans made to plan participants

71. Which item is a highly compensated employee for nondiscrimination testing?

A. Any employee earning more than the median company wage
B. An employee owning more than five percent of the employer
C. Any employee who has completed ten years of service
D. An employee designated as such by the plan administrator

72. Which contribution may an employer still make after the tax year has closed?

A. A savings incentive match plan employer matching contribution

B. A contribution to a plan established after the year ended
C. A contribution to a simplified employee pension arrangement
D. An elective deferral withheld from the employee's own pay

73. Which requirement applies to a farmer using the crop method of accounting?

A. Consent of the Service before the method may be adopted
B. Gross receipts below the applicable statutory threshold
C. Election made on the first return the farmer ever files
D. Use of the accrual method for all other farm activities

74. Which item is excluded from a farmer's gross income?

A. Proceeds from the sale of raised livestock held for breeding
B. Patronage dividends received from a marketing cooperative
C. Payments received under a federal cost-sharing conservation program
D. Custom harvesting fees earned from neighbouring farms

75. Which method values farm inventory for a farmer electing to use it?

A. The retail method, working backward from the eventual sale price
B. The farm-price method, valuing produce at market less disposition costs
C. The specific identification method applied to each animal
D. The lower of cost or market applied to raised produce

76. Which condition must exist before a partner may deduct a partnership loss?

A. The partnership must have distributed cash during the year
B. The partner must have materially participated in the business
C. The partnership must have filed its return before the due date
D. The partner must have sufficient outside basis in the interest

77. Which item increases the basis of a shareholder's S corporation stock?

A. The shareholder's share of tax-exempt income for the year
B. A loan the shareholder makes directly to the corporation
C. A distribution received during the taxable year in cash
D. The corporation's borrowing from an unrelated commercial bank

78. Which item is deducted before the qualified business income deduction is computed?

A. The standard deduction claimed on the individual return
B. Itemized deductions unrelated to the business activity
C. Estimated tax payments made during the taxable year
D. Half of self-employment tax attributable to the qualifying business

79. Which condition applies to the safe harbor treating a rental enterprise as a business?

A. The enterprise must generate positive net income each year
B. Separate books must be maintained and hours of service met
C. The enterprise must hold at least three separate properties
D. The owner must hold a real estate licence in the state

80. Which item is a specified service trade or business under the deduction rules?

A. A business whose principal asset is the reputation or skill of its owners
B. A manufacturing business owned by a small number of individuals
C. A retail business selling goods directly to consumers
D. A construction business performing residential contracts

81. Which item does the Schedule K-1 report that affects a partner's self-employment tax?

A. The partner's ending capital account balance for the year
B. The partner's share of the partnership's total assets
C. The partner's percentage interest in partnership capital
D. The partner's share of net earnings from self-employment

82. Which requirement applies to a partnership's tax matters under the centralized regime?

A. Designation of a partnership representative with a substantial presence
B. Annual ratification of the representative by a partner vote
C. Notification to every partner before any settlement is agreed
D. Consent of partners holding a majority interest to any adjustment

83. Which consequence follows an imputed underpayment at the partnership level?

A. Each partner amends the individual return for the reviewed year
B. The adjustment is spread evenly across the following five years
C. The partnership itself pays the tax at the highest applicable rate
D. The Service collects directly from the partnership representative

84. Which item must a taxpayer track separately after a partial disposition election?

A. The remaining useful life of the entire building structure
B. The basis of the component that was retired from service
C. The original acquisition date of the whole property
D. The accumulated depreciation on all similar properties

85. Which requirement applies to the election to capitalize repair and maintenance costs?

A. It must conform to the treatment used in the taxpayer's books

B. It applies only to buildings rather than to personal property
C. It requires consent of the Service before it may be made
D. It applies retroactively to all open taxable years

86. Which item is subject to the uniform capitalization rules for a producer?

A. Marketing costs promoting the finished goods to buyers
B. Distribution costs of shipping finished goods to customers
C. Costs of storing raw materials awaiting use in production
D. Selling commissions paid on completed customer orders

87. Which condition permits the simplified resale method of allocating costs?

A. The taxpayer must be a reseller rather than a producer
B. The taxpayer must maintain an applicable financial statement
C. The taxpayer must use last-in, first-out for its inventory
D. The taxpayer must be a producer rather than a reseller

88. Which item must an accrual taxpayer include on receiving an advance payment?

A. Nothing until the goods are delivered or services performed
B. The full amount in the year of receipt in every circumstance
C. The amount ratably across the life of the customer contract
D. The amount in receipt year unless deferral to the next year is elected

89. Which item is a change in accounting method requiring consent?

A. A correction of an arithmetical error in a single prior return
B. A change in the estimated salvage value of a depreciable asset
C. A change in the useful life assigned to a newly acquired asset
D. A change from the cash method to the accrual method of accounting

90. Which requirement applies to a taxpayer under automatic consent procedures?

A. Paying a user fee at the time the application is submitted
B. Obtaining a private letter ruling before making the change
C. Filing the application by the due date of the return including extensions
D. Waiting until the following taxable year to implement the change

91. Which item does a business include when computing average annual gross receipts?

A. Only the receipts of the entity filing the particular return
B. Gross receipts of all businesses aggregated under common control
C. Receipts net of cost of goods sold for each business
D. Only receipts from the entity's primary line of business

92. Which condition applies where a business changes from exempt to non-exempt under the gross receipts test?

A. It must change its accounting methods with a Section 481(a) adjustment
B. It may continue its existing methods indefinitely once adopted
C. It must obtain a private letter ruling before making any change
D. It may elect to remain exempt for a further three taxable years

93. Which item is reported on the balance sheet schedule of a corporate return?

A. The reconciliation of book income to taxable income
B. Assets and liabilities at the beginning and end of the year
C. The analysis of unappropriated retained earnings
D. The identification of foreign financial accounts held

94. Which corporation is relieved of completing the reconciliation and balance sheet schedules?

A. One that has elected S corporation status for the year
B. One whose books are maintained on the accrual method
C. One with total receipts and total assets below a stated threshold
D. One that has filed an extension for the taxable year

95. Which item does the more detailed corporate reconciliation schedule require?

A. A listing of every shareholder owning any stock in the corporation
B. Disclosure of all foreign subsidiaries and their earnings
C. A statement of cash flows prepared under accounting standards
D. Separate reporting of temporary and permanent differences by category

96. Which item must a corporation report about substantial stock ownership?

A. Entities and individuals owning twenty percent or more of voting stock
B. Every shareholder regardless of the size of the holding
C. Only shareholders who are also officers of the corporation
D. Only shareholders who received distributions during the year

97. Which condition must be met for corporations to file a consolidated return?

A. Common management of the corporations by the same officers
B. An affiliated group connected through eighty percent stock ownership
C. Operation of the corporations within a single state jurisdiction
D. A written agreement among the shareholders of each corporation

98. Which item is deferred on an intercompany transaction within a consolidated group?

A. Interest paid by one member to an unrelated third-party lender
B. Wages paid by a member to its own employees during the year
C. Rent paid by a member to a landlord outside the group
D. Gain on a sale of property between two group members

99. Which limitation applies to a corporation's losses after an ownership change?

A. An annual limit based on value multiplied by a published rate
B. A complete disallowance of all pre-change losses going forward
C. A limit equal to half the corporation's taxable income each year
D. A five-year suspension before the losses may be used again

100. Which event constitutes an ownership change triggering that limitation?

A. Any sale of stock by a shareholder during the taxable year
B. A change in the corporation's officers or board of directors
C. A more than fifty percentage point increase in five percent shareholders
D. The corporation's election to change its taxable year end

Practice Exam 24: Answer Key and Explanations

1. A — Section 1244 permits an ordinary loss on qualifying small business stock up to one hundred thousand dollars on a joint return, or fifty thousand otherwise. The remaining forty thousand is a capital loss subject to the ordinary capital loss rules. The provision reaches only the original holder, never a purchaser of the shares.

2. B — In a complete liquidation the corporation recognizes gain and loss as though it had sold each asset at fair market value, giving two hundred twenty thousand dollars here. The shareholder separately recognizes gain on the stock. This two-level tax is precisely why liquidating an appreciated C corporation is so expensive.

3. D — The shareholder treats the liquidation as a sale of the stock, recognizing three hundred forty thousand less ninety-five thousand, or two hundred forty-five thousand of gain. The property takes a fair market value basis of three hundred forty thousand. The gain is capital rather than dividend income. The gain is capital rather than dividend income to the holder.

4. C — Where the parent owns at least eighty percent, Section 332 provides that neither the parent nor the subsidiary recognizes gain or loss. The parent takes a carryover basis in the assets and succeeds to the subsidiary's tax attributes. Minority shareholders are taxed under the ordinary liquidation rules instead. Minority shareholders are taxed under the ordinary rules instead.

5. B — Below-market loan rules impute interest at the applicable federal rate, giving twelve thousand five hundred dollars annually. The corporation is treated as paying that amount to the shareholder as a constructive dividend, which it cannot deduct, and as receiving it back as interest income that it must report. The corporation cannot deduct the constructive dividend at all.

6. D — An accrual taxpayer deducts a liability only where all events have occurred fixing the liability, the amount is determinable with reasonable accuracy, and economic performance has occurred. For services, performance occurs as the services are provided, so contracting for future work creates no current deduction whatever. Contracting for future work creates no current deduction whatever.

7. C — The exception allows a deduction in the earlier year where economic performance occurs within the shorter of eight and a half months or a reasonable period after year end, the item recurs and is treated consistently, and it is either immaterial or produces better matching of income and expense. The exception is elective and applies item by item each year.

8. A — Qualified small business stock must be acquired at original issue from a domestic C corporation meeting a gross asset ceiling, held more than five years, with the corporation using substantially all assets in an active qualified trade or business. Purchased shares never qualify however long they are held. Purchased shares never qualify however long they are held.

9. D — Personal holding company income of sixty-four percent exceeds the sixty percent threshold, satisfying the income test. The separate ownership test requires five or fewer individuals to own more than half the stock during the last half of the year. Both tests must be met before the tax applies. Both tests must be satisfied before the tax can apply.

10. A — Short period income is annualized by multiplying by twelve over the number of months, giving two hundred forty thousand dollars. Tax is computed on that figure and then multiplied back by nine twelfths. Annualization prevents a short year from artificially accessing lower brackets or thresholds. Annualization prevents artificial access to lower brackets.

11. C — A Type B reorganization is a stock-for-stock acquisition in which the acquirer must use solely its own voting stock and must hold control immediately after. Any boot whatever defeats the transaction. A Type A statutory merger by contrast tolerates a substantial amount of non-stock consideration. Any boot whatever defeats a Type B reorganization entirely.

12. B — Continuity of interest requires target shareholders to retain a meaningful equity stake in the acquiring corporation. Failure means the transaction is a taxable purchase rather than a reorganization, so gain is recognized immediately. Continuity of business enterprise and a valid business purpose are separate requirements applying alongside it. Business purpose and continuity of enterprise apply alongside.

13. A — A parent-subsidiary controlled group exists where a common parent owns at least eighty percent of one or more corporations. A brother-sister group requires five or fewer persons owning at least eighty percent with more than fifty percent identical ownership. Members share a single set of bracket amounts and limits. Members share a single set of bracket amounts and limits.

14. C — Section 267 disallows a loss on a sale or exchange between related parties entirely. The disallowed loss may reduce the related purchaser's gain on a later resale to an outsider, so the benefit shifts to the buyer. Accrued expenses to related cash-basis payees are deferred until inclusion. Accrued expenses to related cash-basis payees are deferred.

15. D — Long-term contracts generally require the percentage of completion method, recognizing income as costs are incurred relative to total estimated costs. A small contractor exception permits the completed contract method for contracts expected to finish within two years where average gross receipts fall below the applicable threshold. The small contractor exception requires a two-year horizon.

16. B — First-in, first-out assumes the oldest goods are sold first, so the most recent purchase costs remain in ending inventory. In a period of rising prices this produces higher inventory and higher income. Last-in, first-out does the reverse and is why the conformity requirement exists at all. Rising prices therefore produce higher reported income.

17. D — The requirement that a casualty arise in a federally declared disaster applies only to personal-use property. Business and investment property casualty losses remain deductible whatever the cause. The deduction is the lesser of the property's adjusted basis or the decline in value, reduced by any insurance recovery. Insurance recovery reduces the otherwise deductible amount.

18. A — An amount must be capitalized where it results in a betterment, a restoration, or an adaptation to a new or different use. Routine maintenance expected to recur within the applicable period, ordinary repairs, and periodic inspection and cleaning all remain currently deductible under the safe harbors. Routine maintenance safe harbors remain available throughout.

19. C — The caps apply to passenger automobiles, but qualified nonpersonal use vehicles such as those specially modified so personal use is unlikely fall outside them entirely. Heavy vehicles above the gross weight threshold escape the caps but face a separate Section 179 ceiling instead of full expensing. Heavy vehicles face a separate Section 179 ceiling instead.

20. B — Specified research and experimental expenditures must be capitalized and amortized rather than deducted currently, over five years for domestic research and fifteen for foreign. Software development is treated as research for this purpose. The change materially increased taxable income for research-intensive businesses when it took effect. Software development is treated as research for this purpose.

21. D — A business bad debt is proximately related to the taxpayer's trade or business and produces an ordinary deduction, with partial worthlessness allowed. A nonbusiness bad debt gives a short-term capital loss and only on complete worthlessness. Cash-basis taxpayers deduct nothing for uncollected receivables never taken into income. Cash-basis taxpayers deduct nothing for uncollected receivables.

22. B — Agricultural employers file an annual return specific to farm workers rather than the ordinary quarterly return. The smallest employers may be notified to file a different annual return instead of quarterly filings. Federal unemployment tax is reported separately on its own annual return in every case. Unemployment tax is reported separately in every case.

23. C — Backup withholding applies where the payee fails to furnish a correct taxpayer identification number, where the Service notifies the payer of an incorrect number, or in certain underreporting cases. The payer becomes liable for amounts not withheld, which makes collecting a valid certification essential before paying. The payer becomes liable for amounts not properly withheld.

24. A — A trade or business receiving more than ten thousand dollars in cash in one transaction or in related transactions must report it. Cash includes currency and certain monetary instruments but not ordinary personal checks. Deliberately structuring receipts to stay below the threshold is itself a criminal offence. Structuring receipts below the threshold is a criminal offence.

25. A — A working condition fringe is property or a service that would have been deductible by the employee had they paid for it themselves. Cash allowances, commuting reimbursements, and cash equivalents such as gift certificates are all taxable wages regardless of amount, since cash never qualifies as de minimis. Cash never qualifies as a de minimis fringe benefit at all.

26. C — A qualified small employer health reimbursement arrangement permits an employer with fewer than fifty full-time equivalents and no group health plan to reimburse individual premiums and medical costs up to annual limits. It must be offered on the same terms to all eligible employees and funded entirely by the employer.

27. D — A plan loan must generally be repaid within five years through substantially level payments made at least quarterly, with a longer period allowed for a principal residence purchase. The amount is capped by reference to the vested balance. Failure to repay converts the outstanding balance into a deemed distribution. Failure to repay converts the balance into a deemed distribution.

28. B — Income in respect of a decedent is income the decedent had a right to receive but had not included before death, such as a cash-basis proprietor's uncollected receivables. It receives no basis step-up and is taxed to whoever collects it, with a deduction allowed for related estate tax paid. A deduction is allowed for related estate tax that was paid.

29. C — Administration expenses may be deducted on the estate tax return or the fiduciary income tax return, but not both. Claiming them for income tax requires filing a statement waiving the estate tax deduction. Which produces the better result depends on the relative rates applying to each. The better result depends on the relative rates applying.

30. B — A charitable remainder annuity trust pays a fixed dollar amount determined at the outset, while a unitrust pays a fixed percentage of assets revalued annually. Both pay individuals first with the remainder to charity. A lead trust reverses the order, paying charity first and individuals afterward. A lead trust reverses the order of the two beneficiaries.

31. A — The expenditure election replaces the vague substantial part test with a sliding scale based on exempt purpose expenditures, giving an objective safe harbor. Exceeding the limits produces an excise tax rather than immediate revocation, and revocation follows only where the limits are exceeded substantially over four years. Substantial excess over four years still produces revocation.

32. D — Any monetary contribution requires a bank record or written communication from the organization. A contemporaneous written acknowledgment is additionally required at two hundred fifty dollars and above, stating whether goods or services were provided. A qualified appraisal is required for noncash gifts above five thousand dollars. Two hundred fifty dollars triggers the acknowledgment rule.

33. B — Aggregation permits combining separate trades or businesses that share common ownership, operate in coordination, and meet the other regulatory conditions, so wages and property of one can support the deduction of another. A specified service trade or business may never be aggregated with a qualifying business. A specified service business may never be aggregated at all.

34. C — The regulations list nine factors including the businesslike manner of operation, the expertise of the taxpayer or advisers, time and effort expended, expectation of asset appreciation, prior success, history of income and losses, occasional profits, financial status, and elements of personal pleasure. No single factor is determinative under the regulations.

35. A — Relief for a late election requires that the corporation intended to be an S corporation, failed to qualify solely because the election was untimely, has reasonable cause, and acts within a stated period. All shareholders must have reported consistently with S status in the interim. Shareholders must have reported consistently in the interim.

36. D — The other adjustments account holds tax-exempt income and its related nondeductible expenses, which affect stock basis but never enter the accumulated adjustments account. It becomes relevant in the distribution ordering only after the adjustments account and accumulated earnings and profits have both been exhausted. It matters only after the earlier tiers are exhausted.

37. C — An S corporation distributing appreciated property recognizes gain as though it had sold the property at fair market value, and that gain passes through to the shareholders increasing their stock basis. Loss on depreciated property by contrast is not recognized, which makes such distributions particularly unattractive. Loss on depreciated property by contrast is not recognized.

38. B — A domestic partnership must file an annual return reporting its items whether or not it has taxable income, because the return is the mechanism for reporting items to partners. Disregarded entities, grantor trusts, and qualified subchapter S subsidiaries all report through another taxpayer's return instead. The return is the mechanism for reporting items to partners.

39. D — Amounts at risk are reduced by losses previously allowed and by withdrawals, and increased by contributions and by income from the activity. A taxpayer whose at-risk amount falls below zero because of distributions must recapture previously allowed losses as income in that later year. Withdrawals below zero force recapture of earlier losses.

40. A — The election is made by the partnership on a timely filed return and, once made, applies to all subsequent transfers and distributions until revoked with consent. It creates administrative burden because separate basis adjustments must then be tracked for each affected partner individually going forward. Separate adjustments must then be tracked for each partner.

41. D — Capital accounts under the regulations may be revalued when a new partner is admitted, adjusting the existing partners' book capital without touching outside basis. Distributions, deductible expenses, and liability decreases all reduce both figures. The divergence between book capital and tax basis is a persistent source of confusion. Book capital and tax basis diverge persistently as a result.

42. B — Section 704(c) requires that built-in gain or loss on contributed property be allocated to the contributing partner when the property is sold, preventing that partner from shifting pre-contribution appreciation to others. Several permitted methods exist for making the allocation, and the partnership must apply one consistently. Several permitted methods exist and must be applied consistently.

43. A — Where a contribution of property is followed by a related distribution of cash, the two may be recharacterized as a sale. A distribution within two years of the contribution is presumed to be a disguised sale unless the facts establish otherwise, which makes the timing of the two transactions critical.

44. C — Guaranteed payments are separately stated on the Schedule K-1 rather than reported on a Form W-2 or Form 1099. A partner is never an employee of the partnership for these purposes, so no withholding applies and the partner accounts for the tax through estimated payments instead. A partner is never an employee of the partnership itself.

45. D — Organizational expenses are deductible up to five thousand dollars with the remainder amortized over one hundred eighty months, but the recovery period begins with the month the partnership begins business. Costs of admitting partners or syndicating interests are never deductible or amortizable under any circumstance. Syndication costs are excluded from this treatment entirely.

46. C — Syndication costs including brokerage fees, registration expenses, and commissions on selling interests are capitalized permanently with no deduction and no amortization ever available. Genuine organizational costs such as agreement negotiation, accounting setup, and filing fees qualify for the immediate deduction and amortization instead. No deduction and no amortization is ever available for them.

47. A — A partnership must withhold on effectively connected taxable income allocable to foreign partners and remit it quarterly, whether or not any distribution is made. The withheld amounts are credited against the foreign partner's own liability, and the partnership is liable for failing to withhold. The partnership is itself liable for failing to withhold.

48. B — A transferor must notify the partnership of a transfer, which allows the partnership to make required reporting and to apply any Section 754 adjustment. The partnership then files the appropriate statement. Absent notification the partnership cannot fulfil obligations that depend on knowing a transfer occurred. The partnership cannot otherwise know a transfer occurred.

49. A — Foreign taxes are separately stated because each shareholder elects independently whether to claim a credit or a deduction, an election that cannot be made at entity level. Routine depreciation, rent, and salaries carry no shareholder-level variation and are aggregated into ordinary business income. The credit or deduction election belongs to each shareholder.

50. B — Where a termination was inadvertent, the corporation and shareholders take steps to correct it within a reasonable period, and all agree to adjustments the Service requires, relief may be granted so the election is treated as continuing. Absent relief a five-year waiting period generally applies before re-electing. A five-year waiting period otherwise applies before re-electing.

51. D — Interest allocable to the production period of self-constructed property must be capitalized into basis rather than deducted, along with direct materials, direct labour, and allocable indirect costs. Advertising, staff training, and post-completion insurance are period costs deducted currently as they are incurred. Direct materials and labour are capitalized on the same footing.

52. C — Intangibles such as covenants not to compete, goodwill, going concern value, and customer lists are amortized over fifteen years under Section 197. Tangible property including buildings, vehicles, and furniture is depreciated over its own recovery period under the ordinary cost recovery system. Goodwill and going concern value follow the identical rule.

53. B — Remediation costs are currently deductible where they restore property to roughly the condition it was in before the contamination occurred, since no betterment results. Where the work improves the property beyond its former state or adapts it to a new use, capitalization is required instead. Betterment beyond the former state forces capitalization instead.

54. A — Qualified research expenses include in-house wages for those performing, supervising, or supporting research, supplies consumed, and a portion of contract research. Adaptation for a particular customer, foreign research, surveys, and routine data collection are all specifically excluded from the credit computation. A portion of contract research also qualifies for the credit.

55. C — The general business credit is limited to net income tax less the greater of tentative minimum tax or twenty-five percent of net regular tax above twenty-five thousand dollars. Component credits share that single limitation and a common carryback of one year and carryforward of twenty. Carryback is one year and carryforward runs twenty years.

56. D — The credit is available to any employer hiring a member of a targeted group, provided certification is requested from the state workforce agency by the deadline. The wage deduction is reduced by the credit claimed, and the credit forms part of the general business credit. The wage deduction is reduced by the credit amount claimed.

57. A — The credit is available to an eligible small business with gross receipts below a stated ceiling or a limited number of full-time employees. It covers half of eligible access expenditures within a defined band. A separate deduction is available for removing architectural and transportation barriers. A separate deduction covers barrier removal expenditures.

58. D — Personal use of a company vehicle is a taxable fringe benefit and must be valued and included in wages. Accountable plan reimbursements, qualified plan contributions, and the employer's own share of payroll taxes are all excluded from the employee's reportable wage figure. Valuation follows one of several prescribed published methods.

59. C — An employer corrects an employment tax error on the adjusted return corresponding to the original form, generally filed by the due date of the return for the quarter in which the error is discovered. Underpayments corrected promptly may qualify for the interest-free adjustment procedures. Interest-free adjustment applies where correction is prompt.

60. B — The penalty is tiered, rising as the delay lengthens, with a substantially higher amount for intentional disregard and no maximum in that case. Separate penalties apply for failing to file with the Service and for failing to furnish the statement to the payee. Intentional disregard carries a far higher uncapped penalty.

61. B — Executor commissions and other administration expenses are deductible on the fiduciary income tax return where the estate tax deduction is waived. Funeral expenses are never deductible for income tax, federal estate tax is not an income tax deduction, and principal distributions are not expenses. The estate tax deduction must be waived to claim them here.

62. D — A simple trust must distribute all of its income currently, make no charitable contributions, and distribute no corpus during the year. A trust failing any of those conditions in a given year is a complex trust for that year, and the classification is tested annually rather than once. Classification is tested annually rather than fixed at creation.

63. C — Depreciation on trust property is apportioned between the trust and the beneficiaries according to the trust income allocable to each, unless the instrument or local law requires a reserve. The trustee cannot claim the entire deduction where income has been distributed to beneficiaries. A reserve required by the instrument changes that outcome.

64. A — An estate files where gross income is six hundred dollars or more, or where any beneficiary is a nonresident alien. The trust thresholds differ, adding any taxable income at all as an independent trigger. The estate may adopt a fiscal year, which trusts other than certain elections cannot. Estates may adopt a fiscal year, which most trusts cannot.

65. B — The election allows a qualified revocable trust to be treated and taxed as part of the decedent's estate, giving access to the estate's fiscal year, the larger exemption, and other advantages otherwise unavailable. It is made jointly by the executor and the trustee on the estate's return. It is made jointly by the executor and the trustee together.

66. A — Unrelated business gross receipts are excluded from the support fraction. Public contributions, governmental grants, and membership fees all count, though a single donor's contributions count only up to two percent of total support, which prevents one large benefactor from establishing public status alone. One donor counts only up to two percent of total support.

67. D — An organization failing the support test is reclassified as a private foundation, becoming subject to the excise taxes on net investment income, self-dealing, minimum distributions, excess business holdings, jeopardizing investments, and taxable expenditures. Exemption itself is not lost by the reclassification. Exemption itself survives the reclassification unchanged. The organization must then meet the distribution requirements annually.

68. C — A grant to an individual for travel, study, or similar purposes is a taxable expenditure unless the grant procedures were approved in advance. Lobbying, electioneering, and grants without adequate expenditure responsibility are likewise taxable expenditures attracting excise tax on the foundation and its managers. Foundation managers may be taxed alongside the foundation.

69. C — Political campaign intervention on behalf of or against any candidate is absolutely prohibited for charitable organizations and can cost exemption outright, unlike lobbying which is merely limited. Excise taxes on political expenditures may also apply. Social welfare organizations face a different and considerably more permissive standard. Lobbying by contrast is limited rather than prohibited.

70. A — A defined benefit plan promises a specified benefit at retirement, so it requires annual actuarial valuation and minimum funding, with the investment risk falling on the employer. A defined contribution plan promises only the contribution, leaving the participant to bear the investment risk entirely. Investment risk falls on the employer rather than the participant.

71. B — A highly compensated employee is one owning more than five percent of the employer during the current or preceding year, or receiving compensation above an indexed threshold in the preceding year. The employer may elect to limit the second category to the top twenty percent by pay. The employer may elect the top twenty percent by compensation.

72. D — A simplified employee pension may be both established and funded as late as the extended due date of the return, making it the only meaningful option once the year has closed. Elective deferrals must come from pay actually earned during the year and cannot be made retroactively. Deferrals must come from pay actually earned in the year.

73. A — The crop method allows a farmer to deduct the cost of producing a crop in the year the crop income is realized rather than as costs are incurred, which is useful where a crop spans more than one year. It requires the consent of the Service before adoption. It suits crops whose production spans more than one year.

74. C — All or part of a cost-sharing conservation payment may be excluded where the improvement does not substantially increase the property's annual income and the exclusion is elected. Breeding livestock proceeds, patronage dividends, and custom work fees are all includible in farm income. The exclusion must be affirmatively elected by the farmer.

75. B — The farm-price method values inventory at market price less direct costs of disposition and may be applied to raised produce. The unit-livestock-price method assigns standard values by animal class and age. Both are alternatives to cost and require consistent application once adopted. Unit-livestock-price assigns standard values by class and age.

76. D — Basis is the first of four sequential hurdles. Only after basis is satisfied does the at-risk limitation apply, then the passive activity rules, then the excess business loss cap. Material participation matters at the third hurdle rather than the first, and distributions are irrelevant. Material participation matters at the third hurdle instead.

77. B — Tax-exempt income increases stock basis even though it is never taxed, preserving the exemption on eventual disposition. A direct shareholder loan creates separate debt basis rather than stock basis. Distributions reduce stock basis, and corporate third-party borrowing affects neither figure at all. A shareholder loan creates separate debt basis instead.

78. D — Qualified business income is reduced by the deductible half of self-employment tax, the self-employed health insurance deduction, and self-employed retirement contributions attributable to the business. The standard deduction and unrelated itemized deductions affect taxable income but not qualified business income itself. Self-employed health insurance also reduces the qualifying figure. Retirement contributions attributable to the business reduce it too.

79. C — The rental real estate safe harbor requires separate books and records for each enterprise, a minimum number of hours of rental services annually, and contemporaneous records of those services. Property used as a residence by the owner and triple net leased property are both excluded. Triple net leased property is excluded from the safe harbor.

80. A — The catch-all reaches businesses whose principal asset is the reputation or skill of one or more owners or employees, which regulations narrow to endorsement income, licensing an individual's likeness, and appearance fees. Health, law, accounting, consulting, athletics, and financial services are separately listed. Health, law, accounting, and consulting are separately listed.

81. D — The Schedule K-1 separately reports net earnings from self-employment, which differs from the ordinary business income figure because guaranteed payments are added and certain items such as rental income and capital gains are excluded. A limited partner's distributive share is generally excluded entirely. Guaranteed payments are added to reach that particular figure.

82. A — The partnership must designate a representative with a substantial presence in the United States who has exclusive authority to act. Partners have no independent right to notice or participation, and no vote or consent is required, which is why the designation deserves careful attention. Partners have no independent right to notice or participation.

83. C — The default is that the partnership pays an imputed underpayment computed at the highest rate for the reviewed year, borne economically by the current partners. A push-out election shifts the adjustment to the reviewed-year partners instead, which usually produces a fairer economic result. A push-out election shifts it to reviewed-year partners instead.

84. B — A partial disposition election permits recognizing loss on a retired structural component and removing its basis from the asset. The taxpayer must reasonably determine that component's basis, often by discounting current replacement cost back to the acquisition year using a published index. Replacement cost discounted by an index is commonly used.

85. A — A taxpayer may elect to capitalize repair and maintenance costs for tax purposes where those amounts are capitalized on the books. The election is annual, applies to all such amounts for the year, and gives book and tax conformity that simplifies fixed asset record keeping considerably. The election is annual and covers all such amounts.

86. C — Producers must capitalize direct materials, direct labour, and allocable indirect costs including raw material storage, quality control, and production depreciation. Marketing, distribution to customers, selling commissions, and general administration remain period costs deducted currently rather than entering inventory value. Quality control and production depreciation are capitalized too. General administration remains a period cost deducted currently.

87. D — The simplified resale method is available only to resellers, allocating additional capitalizable costs to ending inventory through a mechanical formula. Producers use the simplified production method instead. Both spare the taxpayer a detailed factual allocation of every indirect cost incurred. Producers use the simplified production method instead. Both spare the taxpayer a detailed factual allocation exercise.

88. B — An accrual taxpayer receiving an advance payment includes it in the year of receipt unless it elects the deferral method, which permits deferring the portion not recognized in revenue to the following taxable year only. No deferral beyond that single year is available under any circumstance. No deferral beyond that single year is ever available.

89. D — A change in the overall method of accounting, in the treatment of a material item, or in inventory valuation requires consent. Corrections of arithmetical errors, changes in estimates, and treatment of genuinely new assets are not method changes and require no application at all. Changes in estimate are not method changes at all.

90. C — Automatic consent procedures require filing the application with the timely filed return including extensions, with a copy sent separately, and no user fee is payable. Non-automatic changes require an earlier filing, a user fee, and a ruling before the change may be implemented. Non-automatic changes carry a fee and an earlier deadline.

91. B — Aggregation rules require combining gross receipts of businesses under common control or in an affiliated service group. Receipts are measured gross without reduction for cost of goods sold, and short years are annualized. The three-year average then governs several important statutory thresholds. Short years are annualized before the average is computed.

92. A — Crossing the threshold requires changing to the accrual method, applying inventory accounting, and applying the capitalization rules, each a method change generating a Section 481(a) adjustment. A positive adjustment spreads over four years, softening what would otherwise be a severe single-year impact. A positive adjustment spreads across four taxable years.

93. B — The balance sheet schedule presents assets, liabilities, and equity at both the beginning and end of the year as recorded on the books. The separate reconciliation schedules explain the difference between book and taxable income and analyse retained earnings movements respectively. Both schedules draw directly from the taxpayer's own books.

94. C — A corporation with total receipts and total assets each below the stated threshold at year end need not complete the balance sheet and reconciliation schedules. Larger corporations complete a more detailed reconciliation schedule instead, which requires far greater disclosure of book and tax differences. Larger corporations complete the detailed schedule instead.

95. D — The detailed schedule requires separating temporary from permanent differences and reporting each category of difference individually, giving substantially more transparency than the simple reconciliation. It applies to corporations above the asset threshold and has materially changed how large corporate returns are examined. It applies above a stated total asset threshold each year.

96. A — The corporation must identify entities and individuals owning directly or indirectly twenty percent or more of the total voting power, and separately those owning fifty percent or more. The disclosure supports the controlled group, related party, and consolidated return rules applying elsewhere. Fifty percent ownership is separately disclosed as well.

97. B — An affiliated group requires a common parent owning at least eighty percent of the voting power and value of at least one includible corporation, with the chain continuing through the group. Filing consolidated is elective but binding, and consent of every member is required. Filing consolidated is elective but binding once elected.

98. D — Gain or loss on an intercompany transaction is deferred until the property leaves the group or another triggering event occurs, preventing artificial recognition through internal transfers. Transactions with parties outside the group are recognized normally in the year they occur. Recognition follows when the property leaves the group. Internal transfers cannot therefore accelerate recognition artificially.

99. A — Following an ownership change the annual use of pre-change losses is limited to the value of the loss corporation multiplied by a published long-term tax-exempt rate. The rule prevents trafficking in loss corporations, and unused amounts carry forward subject to the same annual ceiling. Unused amounts carry forward under the same annual ceiling.

100. C — An ownership change occurs where the percentage owned by five percent shareholders increases by more than fifty percentage points over a three-year testing period. Ordinary trading among small holders does not trigger it, but a significant equity investment or acquisition frequently does. Ordinary trading among small holders does not trigger it.